No. 15,229

United States Court of Appeals

For the Ninth Circuit

STEPHEN G. ACHONG,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Appeal from The Tax Court of the United States.

BRIEF FOR PETITIONER.

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JURISDICTION.

On April 2, 1951, Petitioner, Stephen G. Achong, filed a Petition in The Tax Court of the United States against the Commissioner of Internal Revenue, Respondent, for a redetermination of income tax deficiencies asserted by the Respondent against the Petitioner for income taxes for the calendar years 1946 and 1947 in the amounts of $10,799.76 and $1,105.69, respectively, a total amount of $11,905.45, of which $11,721.41 is in dispute. (R. 3-15.)

Petitioner is an individual, a citizen of the United States, and a resident of City and County of Honolulu, Territory of Hawaii. His income tax returns for the years here involved were filed with the (then) Collector of Internal Revenue, District of Hawaii, at Honolulu, Hawaii. (R. 18.)

Jurisdiction over the case was conferred upon The Tax Court of the United States pursuant to I.R.C. (1939) Sec. 1101.

The case was heard on July 22, 1954, in a Division of The Tax Court of the United States sitting in Honolulu, Hawaii, the Honorable C. P. LeMire Presiding. (R. 2.) The Tax Court of the United States entered its Memorandum findings of fact and Opinion on March 26, 1956 and its Decision (T. C. Memo. 1956-73, Docket No. 33,319) on March 27, 1956. The Decision, in favor of the Respondent, is that there are deficiencies in income taxes of Petitioner in the amount of $10,799.76 for the year 1946 and of $1,105.69 for the year 1947. (R. 2, 42-48.)

On June 26, 1956, within three months from the entry of the Decision, Petitioner perfected his appeal to this Court by the filing of his Petition for Review, Bond, Notice of filing Petition for Review, Designation of Contents of Record on Appeal, and Praecipe for Record. (R. 2-3, 49-54.)

Jurisdiction over this case on appeal is conferred upon this Court pursuant to Title 26, U.S.C., Secs. 7482 and 7483.

STATEMENT OF FACTS.

The facts in this case were for the most part agreed to. In addition thereto the Petitioner testified briefly. The facts are restated and summarized as follows:

1. The Petitioner is an individual, 67 years old (born October 28, 1887), unmarried, a citizen of the

United States, and a resident of the City and County of Honolulu, Territory of Hawaii. His home address is 45-503 Kamehameha Highway, Kaneohe, Oahu, Territory of Hawaii. The income tax returns for the years here involved were filed with the (then) Collector of Internal Revenue, District of Hawaii, at Honolulu, Hawaii. (R. 18.)

2. The notice of deficiency, a copy of which is attached to the petition as Exhibit A, was mailed to the Petitioner on March 14, 1951. (R. 18.)

3. The deficiencies as determined by the Commissioner of Internal Revenue are in income taxes for the calendar years 1946 and 1947 in the amounts of $10,799.76 and $1,105.69, respectively, a total of $11,905.45, of which $11,721.41 is in dispute. For the calendar year 1946 the taxpayer reported and paid a tax of $8,284.93 and the Commissioner of Internal Revenue claims a tax of $19,084.69. For the calendar year 1947 the taxpayer reported and paid a tax of $1,926.93 and the Commissioner of Internal Revenue claims a tax of $3,032.62. Petitioner admits an additional tax for the calendar year 1946 of $184.04. (R. 18-19.)

4. On August 17, 1923, Petitioner was issued a deed, Land Patent No. 8277 (Exhibit 2), to 11.63 (11.55 net) acres of government land at Halekou-Waikaluakai Homesteads, Koolaupoko, Oahu, Territory of Hawaii, pursuant to Special Homestead Agreement No. 1170 (Exhibit 1), in accordance with the provisions of Section 73 of the Hawaiian Organic Act and Sections 352, et seq., of the Revised Laws of Hawaii 1915. (R. 19.)

5. In 1915 Petitioner erected a dwelling on the said homestead land and has occupied the said dwelling as his home continuously from 1915 to the present time. (R. 19, 32-34, 37.)

6. From time to time during the period from the date of Special Homestead Agreement No. 1170 (Exhibit 1) until 1946 Petitioner leased portions of the said homestead land to various tenants under short term tenancy agreements for farming purposes. (R. 19, 32-35.)

7. Petitioner was employed full time as a cashier by Metropolitan Meat Market No. 1, Honolulu, from 1914 until his retirement in 1950. During this period and up to the present time, he has never held any other job or had any other employment. He has never had any office or place of business of his own. He has never owned or held title to any real property other than the above described homestead land. (R. 19-20, 38.) He has never bought or sold any other real property. (R. 38.)

8. In 1946, Samuel W. King, a real estate broker and dealer in land, asked Petitioner if Petitioner would sell all or any portion of the said homestead land. After several discussions Petitioner and Samuel W. King entered into a written agreement dated June 27, 1946, relative to the sale of this land. (Exhibit 3.) Immediately thereafter Samuel W. King opened an account in his books in the name of Petitioner. (R. 20, 35-36.) Samuel W. King is an old friend of Petitioner. (R. 37.)

9. Pursuant to the said agreement (Exhibit 3), Samuel W. King prepared a proposed subdivision of the homestead land in accordance with the Revised Ordinances of the City and County of Honolulu 1942 and the Revised Laws of Hawaii 1935. This proposed subdivision (Exhibit 4), was approved by Petitioner and on August 1, 1946, was given Preliminary Approval, and on January 15, 1948, Final Approval, by the City Planning Commission of the City and County of Honolulu as required by law. (R. 20.)

10. The applicable ordinances of the City and County of Honolulu and the applicable laws of the Territory of Hawaii provided that a subdivider of rural land need install only necessary streets and water mains, including fire hydrants. Sewers, sidewalks, and electric and gas utilities were not required by law. (R. 20-21.)

11. In connection with the preparation of the aforesaid plan of subdivision and the construction of the required improvements, and acting under the agreement of June 27, 1946, and with the approval of Petitioner, Samuel W. King retained the Paul Low Engineering and Construction Company. On August 24, 1946, this engineering firm submitted an estimate of construction items. (Exhibit 5.) On October 22, 1946, Samuel W. King and the Paul Low Engineering and Construction Company entered into a written agreement approved by Petitioner for the construction of the necessary improvements. (Exhibit 6.) Costs of the survey, subdivision, construction and file plans,

and final staking out were charged and paid for separately. (Exhibit 7.) The required improvements contracted for were completed and accepted in February, 1947, and the roadway was conveyed to the Territory of Hawaii on December 5, 1949. (R. 21.)

12. Payments to the Paul Low Engineering and Construction Company were billed to and made by Samuel W. King in accordance with the terms of the contract between them (Exhibit 6) as follows:

Payment (a) of $6,400.00 on November 25, 1946;
Payment (d) of $1,600.00 on December 11, 1946;
Payment (b) of $6,400.00 on January 14, 1947;
Payment (c) of $6,400.00 on January 31, 1947;
Half of payment (e) or $4,000.00 on December 22, 1947;
The balance of payment (e) or $4,000.00 on January 14, 1948;
Final payment (f) of $3,200.00 on January 29, 1948.

The charge for surveying, et cetera (Exhibit 7) was billed to and paid by Samuel W. King as follows:

$2,700.00 on November 14, 1946; and
$300.00 on February 17, 1947.

All payments were charged to the account of Petitioner in the books of Samuel W. King. (R. 21-22.)

13. In the approved subdivision (Exhibit 4), Lots 16, 32 and 33 were reserved by Petitioner and are still unsold. Lot 16 was and is set aside as Petitioner's own residential lot and includes the dwelling occupied by Petitioner. Lots 32 and 33 were and are reserved

for possible future business use. All of the remaining lots were sold as set forth below. (R. 22.)

14. Following the execution of the agreement of June 27, 1946 (Exhibit 3), Samuel W. King had certain forms prepared to be used in connection with the sale of lots in the proposed subdivision, called the Puahuula Subdivision. These forms included a Deposit Receipt and Contract (Exhibit 8), Deed and Mortgage. During the period July 18, 1946 to November 19, 1946, Deposit Receipt and Contract forms were executed by purchasers for all 30 lots offered for sale. Some of these original contracts were modified or cancelled as detailed below. (R. 22-23.)

15. The detailed history of the sale of each lot is as follows:

Lot No.	Purchaser	Date of Deposit Receipt and Contract	Date of Deed
1.	MERCADO	7-26-46	11-25-46
2.	CARVALHO	8-10-46	11-19-46
3.	QUON	8-16-46	11-25-46
4.	BRANDT	8-17-46	11-25-46
5. } 6. }	CYPHER, G	8-23-46	11-19-46
7.	FORDE	9-10-46	11-19-46
8.	KEANE	8-17-46	11-19-46
9.	CAZINHA	8-19-46	11-25-46
10. } 11. }	LUKE	8-13-46	11-19-46
12.	YASUDA	8-11-46	11-19-46
13.	RIDENOUR	8-17-46	12- 5-46
14.	KEENE	8-10-46	11-19-46

Lot No.	Purchaser	Date of Deposit Receipt and Contract	Date of Deed
15.	LI	8-10-46	11-19-46
16.	Reserved as Petitioner's Residence.		
17.	WON, P.	8-10-46	11-19-46
18. 19.	ACHONG, H.	8-17-46	Cancelled 11-18-46
18.	ACHONG, H.	11-18-46	11-25-46
19.	HALUALANI	11-19-46	11-25-46
20.	YAMANE	8-17-46	Cancelled 11-12-46
20.	HALUALANI	11-14-46	11-25-46
21.	NAVARRO	8-27-46	12-10-46
22.	CYPHER, C.	8-27-46	11-25-46
23.	TOBALADO	9- 4-46	11-19-46
24.	MUNN	9-10-46	11-19-46
25. 26.	ROSS	8-14-46	Cancelled 12-28-46
25.	KING, P.	5- 1-47	5-27-47
26.	TANIOKA	6- 4-48	4-14-48
27. 28.	MURABAYSHI	7-18-46	11-19-46
29.	WON, J.	8-26-46	11-19-46
30. 31.	McPHERSON	7-26-46	11-19-46
32. 33.	Reserved for Possible Future Business Use.		

(R. 23-24.)

16. The details of the terms of sale of and payments for each lot are as follows:

Lot No.	Price	Total Deposit	Balance
1.	$4,200	$1,050	Mtge 11-25-46
2.	3,465	350	Cash 11- 8-46
3.	3,519	1,850	Cash 11-25-46
4.	3,548	1,000	Mtge 11-25-46
5. } 6. }	7,178	1,800	Mtge 11-19-46
7.	3,133	783.50	Mtge 11-19-46
8.	3,653	913	Mtge 11-19-46
9.	3,688	370	Cash 1-14-47
10. } 11. }	7,458	740	Cash 11- 7-46
12.	3,770	380	Cash 11-19-46
13.	3,800	380	Cash 12-16-46
14.	3,825	3,285	Note 11-19-46
15.	3,855	1,850	Cash 11- 7-46
16.	Reserved		
17.	3,240	810	Mtge 11-19-46
18.	3,466	866.50	Mtge 11-25-46
19.	4,700	1,175	Mtge 12-11-46
20.	4,740	1,180	Mtge 11-25-46
21.	3,588	897	Mtge 12-10-46
22.	3,620	365	Mtge 11-25-46
23.	3,557	890	Mtge 11-19-46
24.	3,222	795.50	Cash 12-29-46
25.	4,996	.....	Cash 5- 2-47
26.	4,996	1,660	Mtge 6-16-48
27. } 28. }	7,590	750	Cash 11- 4-46
29.	3,840	960	Mtge 11-19-46
30. } 31. }	7,780	700	Cash 11-13-46
32. } 33. }	Reserved		

(R. 24-25.)

17. The details of the purchase money mortgages outstanding during the calendar years 1946 and 1947 are as follows:

Lot No.	Amount of Mortgage	Monthly Payment (Inc. Int.)	Paid in 1947 Prin.	Int.
1.	$3,150	$50.00	$ 148.52	$151.66
4.	2,548	50.00	442.36	107.64
5. 6.	5,378	60.00	1,278.41	215.61
7.	2,349.50	50.00	449.70	110.62
8.	2,740	40.00	321.04	118.96
14.	540 (note)	50.00	540.00	13.09
17.	2,430	50.00	447.87	102.13
18.	2,599.50	50.00	439.96	110.04
19.	3,525	50.00	375.00	115.96
20.	3,560	50.00	375.00	153.60
21.	2,691	50.00	428.69	126.31
22.	3,255	50.00	622.94	67.06
23.	2,667	50.00	764.55	95.35
26.	3,336	50.00	.....	.....
29.	2,880	50.00	374.79	125.21

There were no mortgage payments during the calendar year 1946. (R. 25.)

18. Total costs incurred under the agreement of June 27, 1946 (Exhibit 3) as of December 31, 1946, were as follows:

Construction of improvements	$32,000.00
Survey, plans, staking	3,000.00
Legal expense	200.00
Certificate of title	30.00
Blue prints of tract	7.85

Stamp taxes	123.00
Deeds	230.00
Acknowledgments	25.00
Sales commissions	10,443.50

Additional costs thereafter included only sales commissions, cost of papers, revenue stamps, certificates of title, notary fees, legal and accounting fees. (R. 25-26.)

19. All sales were made by Samuel W. King without any advertising of any kind. No signs were erected on the property. Samuel W. King maintained a real estate office which indicated that he had property of the type herein involved for sale. The lots were sold through the activities of Samuel W. King by either contacting persons whom he believed to be prospective purchasers or by Samuel W. King suggesting to prospective purchasers who contacted him that the lots in question were for sale. Petitioner took no part in negotiating any of the said sales. Purchasers were for the most part relatives or friends living in the Kaneohe area (where the homestead is located). The purchasers of Lots 2, 15, 17, 18 and 29 are related to Petitioner by blood or marriage. The purchasers of Lots 8, 14, and 25 are related to Samuel W. King by marriage. All lots were sold on Deposit Receipt and Contract forms before any subdivision improvements were constructed, but on the representation that improvements would be constructed. Samuel W. King received all payments, processed all papers, and made all disbursements, crediting and debiting Petitioner's

account in the books of Samuel W. King as appropriate, and rendering periodic statements to Petitioner. While none of the proceeds have been actually turned over to Petitioner, all proceeds were credited to the account of Petitioner and Samuel W. King has invested the net amount thereof for Petitioner. (R. 26-27, 36-38.)

20. Petitioner elected, in his individual income tax returns for the calendar years 1946 and 1947, to return on the installment basis the gains realized from sales of his homestead land. In his income tax return for the calendar year 1946, he reported a gain from the sale of his homestead land of $34,542.80. The Commissioner has determined that the correct amount of gain was $35,199.48. Petitioner admits that the correct amount of gain for the calendar year 1946 was $35,199.48. (R. 17.)

QUESTION INVOLVED.

Was the income realized by the Petitioner in the taxable years 1946 and 1947 from the sale of his homestead land ordinary income or capital gain?

SPECIFICATION OF ERRORS.

1. The Court erred in holding that the land in question was held by Petitioner primarily for sale to customers in the ordinary course of his trade or business, and in failing to hold instead that the land was a capital asset.

2. The Court erred in holding that the gains realized by the Petitioner from the sale of his homestead during the taxable years 1946 and 1947 were ordinary income, and in failing to hold instead that the gains were long-term capital gains.

3. The Court erred in holding that there are deficiencies of $10,799.76 and $1,105.69, respectively, in the Petitioner's returns for income taxes for the calendar years 1946 and 1947, and in failing to determine instead, that there is a deficiency of $184.04 in the Petitioner's return for income tax for the calendar year 1946 and that Petitioner's original return of income tax for the calendar year 1947 was correct.

SUMMARY OF ARGUMENT.

I. The gains realized on the sale of Petitioner's homestead land were capital gains and not ordinary income because:

A. The homestead land was acquired and continuously held by Petitioner for more than six months as a home for himself and as agricultural land for the growing of crops, and not primarily for sale to customers in the ordinary course of trade or business.

B. Petitioner was not engaged in the business of selling real property during either of the taxable years 1946 and 1947, or at any other time.

ARGUMENT.

I.

THE GAINS REALIZED ON THE SALE OF PETITIONER'S HOMESTEAD LAND WERE CAPITAL GAINS AND NOT ORDINARY INCOME BECAUSE:

A. The homestead land was acquired and continuously held by Petitioner for more than six months as a home for himself and as agricultural land for the growing of crops, and not primarily for sale to customers in the ordinary course of trade or business.

The Petitioner contends that the lots sold by him during the years 1946 and 1947 were capital assets within the meaning of Section 117 (a) (1) of the Internal Revenue Code of 1939 and any gains realized by him upon the sale of the lots were long-term capital gains within the meaning of Section 117 (a) (4) of the Code. Those provisions of the Code read as follows:

> "Sec. 117. CAPITAL GAINS AND LOSSES.
>
> (a) Definitions—As used in this chapter—
>
> (1) Capital Assets—The term 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include— * * *
>
> (4) Long term capital gain—The term 'Long-term capital gain' means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;"

Petitioner first acquired an interest in the homestead land in question in 1914 as the purchaser under

a Special Homestead Agreement issued by the government of the Territory of Hawaii. *Fact 4.*

This agreement (Ex. 1) provides among other things:

> "The Purchaser enters into this agreement with the intention of maintaining his home and residing on said land permanently and, except as otherwise hereinafter provided, shall maintain his home and reside upon said land at least five (5) years during the first ten (10) years after said date, such maintenance of a home and residence to begin within two years after said date, and no period of less than six (6) months of continuous residence at said home shall be held to be a part of said five years.
>
> "Neither said land nor any part thereof or interest therein or control thereof shall, without the written consent of the Commissioner and Governor, be or be contracted to be in any way, directly or indirectly, by process of law or otherwise, conveyed, mortgaged, leased, or otherwise transferred to or acquired or held by or for the benefit of any other person, before a patent has been issued thereon; * * *
>
> "Ten (10) years after said date or at any time within two years thereafter, if all the covenants and conditions have been observed and performed, of which observance and performance the Purchaser shall make affirmative proof, the Purchaser if he is now or shall then and within five years after said date have become a citizen of the United States, shall be entitled to a patent conveying said land in fee simple: Provided, that the Purchaser shall be entitled to such patent at

> any time after three years within said ten years, if he has observed and performed all covenants and conditions so far as required up to that time, and has paid the entire purchase price, and has maintained his home and resided on said land for at least three (3) years continuously, and has cultivated and maintained under cultivation as aforesaid at least 50 per cent of said land, and had and maintained at least twenty-five (25) growing trees per acre upon the remainder of said land, for at least three (3) years continuously."

Petitioner moved onto the land in 1915 and has lived there ever since. *Fact 5.* Except for the area occupied by Petitioner as a home, the land was farmed from about 1918 to 1930, remained idle from about 1930 to 1940, and then farmed again from 1940 to 1946. (R. 31-36.)

He received his patent (Ex. 2) in 1923, having complied with the provisions of the Special Homestead Agreement. (Ex. 1.) While the patent (Ex. 2) does convey the 11.63 acres of homestead land in fee simple, it nevertheless is subject to the restrictions set forth in Section 73 of the Hawaiian Organic Act (a federal statute), prohibiting aliens, corporations, or persons owning other lands which together with any part of this land would add up to 80 acres, from having any interest in the homestead land without the consent of the Governor and the Commissioner of Public Lands.

It is absolutely certain from this recital that the homestead land in question was not acquired primarily for sale to customers in the ordinary course of trade or business.

Furthermore, there can be no doubt whatsoever that this homestead land was continuously held by Petitioner for a period of over 31 years, from 1914 to 1946, as a home and farm for himself, and not primarily for sale to customers in the ordinary course of trade or business. Respondent does not contend that there was any activity by Petitioner or any one on his behalf prior to 1946 looking toward the sale of the whole or any part of Petitioner's homestead.

Clearly, therefore, if Petitioner in 1946 had sold his entire homestead to one buyer without causing it to be subdivided, any gain realized from such a sale would have been unquestionably a capital gain and not ordinary income.

But Petitioner is not required to limit himself to such a single sale in order to stay within the provisions of the Internal Revenue Code relating to capital gains.

In *Boomhower v. United States,* 74 F. Supp. 997 (DC ND Iowa, 1947), the taxpayer was a lawyer who acquired a 20-acre tract of unimproved pasture land. The land was platted, improved, advertised, and sold over a period of time. The Court held that the gains realized were capital gains, saying in part:

> "The purpose of the statutory allowance of a lower rate of taxation on the gain derived from the conversion of capital assets is to alleviate the burden which would be incurred by the taxpayer, should that gain be classified as ordinary income over a short tax period when, in fact, it had accrued over a long period of investment, and to

remove the deterrent effect of that burden on such conversions * * *

"Several tests have been referred to by the courts in analyzing the nature of the transaction by a taxpayer for the purpose of determining which * * * sections of the Internal Revenue Law shall be applied. Continuity of sales or sale related activity over a period of time * * * Frequency of sales, as opposed to isolated transactions * * * The activity of the seller or those acting under his instruction or in his behalf, or the time and labor given to effect the transaction, such as by improvements or advertisement to attract purchasers * * * The extent or substantiality of the transaction * * * The reasons for, purpose or nature of the acquisition of the subject matter * * * Some courts have similarly attached weight to the reason for, purpose or nature of the sale of the subject matter. A taxpayer's claim that his only desire was to convert or liquidate an asset rather than to conduct a business would then be of importance for judicial consideration. This 'liquidation test', however, has generally been rejected by a recognition that the activity of the taxpayer in disposing of the subject matter could reach the proportion of one doing business regardless of his impelling motives * * *"

In *Dillon v. Commissioner of Int. Rev.*, 213 F (2d) 218 (CA 8 1954), the taxpayer was a contractor who had built housing units under an arrangement with the FHA whereby the units would be rented to defense workers at a fixed rental and would not be disposed of except as authorized by the FHA. A corporation organized by the contractor held title to the

houses and the land on which they were constructed. When the 20 houses in issue were completed in 1944 and 1945 they were deeded to the contractor. In 1945 all restrictions on the rental and sale of the houses were lifted. In 1946 the 20 houses were sold through a company engaged in the real estate business. The Court held that the gain from the sales of these houses was a capital gain, saying in part:

> "One may, of course, liquidate a capital asset. To do so it is necessary to sell. The sale may be conducted in the most advantageous manner to the seller and he will not lose the benefits of the capital gain provision of the statute, unless he enters the real estate business and carries on the sale in the manner in which such a business is ordinarily conducted. In that event, the liquidation constitutes a business and a sale in the ordinary course of such a business and the preferred tax status is lost."

In *Fahs v. Crawford,* 161 F (2d) 315 (CCA 5 1947), the taxpayer was a lawyer who bought an interest in a tract of subdivided land as a speculative investment. After several years of trying to sell the land, the owners were approached by a man who was a contractor, real estate broker and developer with a scheme for selling the land with FHA financing which however required the construction of additional improvements, which was done. In holding that the gain from the sale of this land in lots was a capital gain the Court said in part:

> "Clearly these lands were originally purchased by the taxpayer as an investment. Though already

platted into subdivision, the lands were purchased en bloc, and the owners attempted to sell them as a whole. Failing, they tried sale at retail through a broker. This effort met with but small success. From 1925 to 1938 they again held the lands for sale as a whole, without success. It was then they were approached by Commander with the method of sale above described. Nothing could be done until the property was approved for FHA loans, and a condition of that approval was water, lights and paving. These the taxpayer and Commander set out together to secure, in order to render the property saleable—the taxpayer in order to dispose of his investment—Commander in order to earn profits in his business as a building contractor, real estate broker and developer, in all of which activities there were prospective profits for him. In effect, what the taxpayer was doing was to render more attractive a capital asset already owned in order to sell it, in much the same way as an owner would paint and redecorate an old house, and landscape the grounds, in order that his broker could more readily dispose of it for him. These activities were but preliminaries. After FHA approval of the lands had been secured for loans, the taxpayer devoted no part of his time to any activity connected with the sale or development of the lots. This selling was carried on independently by Commander, without any supervision or control by the taxpayer.''

Applying the principles of these cases to the case at hand, what do we find?

Petitioner acquired his homestead land as a personal residence and farm. *Fact 4.* The increase in value re-

sulting in the gain which is at issue accumulated over a period of more than 31 years. Petitioner decided to sell that portion of his homestead which he was not occupying as a residence because the character of the area had changed from farming to residential, because his friends and relatives were urging him to let them buy his land, and because he was getting along in years and had no direct descendants to whom to leave his land. (R. 36-37.)

The shape of his homestead land was such that the rear portion could not be reached without a road. (Ex. 4.) It would not have been practicable to hold out a residential area for himself and sell the balance of the homestead without a road, and once a road was put down the middle of the land, the division of the area into lots required no extra expense other than staking.

Only the minimum improvements necessary to satisfy the requirements of the City and County of Honolulu were constructed. *Fact 9.* All sales were consummated before any improvements were actually constructed. *Fact 19.*

Petitioner himself did not take an active part in selling the land. *Fact 19.* He has never been in the real estate business. *Fact 7.* All sales were consummated without any advertising of any kind. *Fact 19.* Purchasers were largely friends, neighbors and relatives of Petitioner. *Fact 19.* All lots were originally sold in a period of only two months. *Fact 15.* Thereafter there were only 5 sales, 3 in November, 1946, one in

May, 1947, and one in June, 1948, because of cancellations of original sales. *Fact 15.*

The facts of this case, in short, bring it squarely within the reason and purpose of the capital gain provisions of the Internal Revenue Code, and also squarely within the principles of the decided cases.

In *Ellis v. Commissioner,* Docket Nos. 34505 and 34506, T. C. Memo decision, entered January 13, 1954 (CCH Dec. 20,106 (m)), taxpayers were husband and wife. Dr. Ellis was a physician and had a full time college teaching position. In 1935 he inherited 166 acres of land. This is the only land he ever owned. Prior to 1946 it was used as agricultural land. In 1946 he subdivided 44 acres into 72 lots suitable for home building. He hired an engineering firm to survey and put in improvements consisting of an improved road, culverts, and so forth. He hired a Mr. Taylor to supervise the details of the subdivision and to handle the sale of the lots. Taylor was not a real estate salesman but was building his own home on the subdivision and available most of the time to meet prospective purchasers. The sale of the lots was advertised by placing a sign on the property bearing the name of the development and Dr. Ellis' number. The lots were sold during 1946, 1947, 1948. Both Taylor and Ellis made sales. Over 70% of all sales were made within two months after the tract was opened in 1946. Mrs. Ellis kept the records.

The Court decided that the gains realized from these sales were capital gains.

In *Thrift v. Commissioner,* 15 T. C. 366 (1950), the taxpayer had purchased 62 acres of unimproved land. In 1944 and 1945 he was approached to sell the land. He put a price on the land but no sale was consummated. He then opened negotiations with a group of home builders who were interested in building houses on the land but lacked the necessary capital to install streets, sewers, and water lines. In the latter part of 1945, pursuant to a general understanding with the home builders, he caused the land to be platted into 238 lots, and put in the improvements. He made no effort to sell the property to the general public. The property was never listed with a real estate agent nor advertised in any way. He sold only to the builders (5 in number) and to his son.

The Court held that the gains realized from the sale of these lots were capital gains.

B. Petitioner was not engaged in the business of selling real property during either of the taxable years 1946 or 1947, or at any other time.

It is clear that Petitioner has never consciously engaged in the real estate business. *Fact 7.* The only land he has ever sold in his entire lifetime is the land in question. As to this, he took no part in effecting any of the sales made. *Fact 19.*

The fact that Samuel W. King was an experienced real estate broker is not determinative because even he did not engage in any extensive activity in order to process the sales of Petitioner's homestead land. *Fact 19.* The land actually sold itself.

In *Pope v. Commissioner,* 77 F (2d) 599 (CCA 6, 1935), the Court held that the sale of land through real estate brokers did not of itself make the sale a sale by the taxpayers in the ordinary course of the taxpayers' trade or business.

In *Snell v. Commissioner,* 97 F (2d) 891 (CCA 5, 1938), it was said that business means "business" and implies that someone is kept more or less busy.

In *Boomhower v. United States, supra,* it was said that the occasional purchase and resale of land by an investor speculating on a rise in real estate values does not of itself make him a dealer in real estate for income tax purposes. See also *Fahs v. Crawford, supra.*

In *Dunlap v. Oldham Lumber Co.,* 178 F (2d) 781 (CA 5, 1950), the taxpayer acquired some vacant lots in a platted and approved subdivision in 1928. Several years later utilities were installed by the taxpayer. The lots were offered for sale through a real estate agent. A few lots were sold between 1937 and 1943. 27 lots were sold in 1944 and 7 in 1945. The Court held that the losses sustained as a result of these sales were capital losses, saying in part:

> "The evidence is wholly insufficient to show any sustained real estate business on the part of the taxpayer. Even if there could be any possible room for disagreement as to the above review of the evidence, clearly there can be no dispute of the proposition that under the evidence here there is no basis for the finding that there were sufficient sales transactions to show that such sales of real estate were an ordinary course of business

of the taxpayer * * * The conclusion is inescapable that the sale of the lots was most extraordinary and not at all ordinary, and there was no ordinary course of business as to lot sales * * *''

It is equally clear that Samuel W. King was an independent contractor and not Petitioner's agent. In *Smith v. Dunn,* 224 F (2d) 353 (CA 5, 1955), the taxpayer owned a large tract of land which he inherited and which had been in the family for more than fifty years. He was a practicing architect; he had never engaged in the real estate business and had no office except that in which he practiced his profession. In 1946, with the intent of liquidating his holdings in the tract, he decided that it should be subdivided into lots and he employed an engineer who made the surveys and the subdivision. At that time the tract was undeveloped except for two roads running through it. The taxpayer also employed a real estate broker named Duffee to handle the sale of the lots. He made suggestions concerning the size of the lots and the best manner of making the subdivision and a sales price of the lots was discussed and tentatively agreed upon. Lots adjacent to the existing roads were first sold and thereafter two additional streets were opened, water mains installed and other improvements made, the total cost of which amounted to approximately $32,000. Duffee was to have ten per cent commission, to advertise according to his own ideas, to fix the prices in line with the general agreement had at the outset, to pay all expenses and to remit to the taxpayer the net balance. Duffee employed his own salesmen, decided

upon and arranged for his own advertisements in his own name, developed his own clientele, and made sales to customers sought out and chosen by him alone. The Court decided that Duffee was an independent contractor and that the gains realized by the taxpayer from the sale of the lots were capital gains. Unquestionably the facts of *Smith v. Dunn* fall squarely in line with the facts of the instant case.

CONCLUSION.

The Tax Court of the United States has erred in determining that the Petitioner's homestead, a substantial portion of which was sold during the calendar years 1946 and 1947, had been held by him primarily for sale to customers in the ordinary course of his trade or business, and in failing to determine instead, that the said land was a capital asset.

The Tax Court of the United States has erred in determining that the gains realized by the Petitioner from sales of a substantial portion of his homestead during the calendar years 1946 and 1947 were ordinary income, and in failing to determine instead, that the said gains were long-term capital gains.

The Tax Court of the United States has erred in determining that there are deficiencies of $10,799.76 and $1,105.69, respectively, in the Petitioner's returns of income taxes for the calendar years 1946 and 1947, and in failing to determine instead, that there is a deficiency of $184.04 in the Petitioner's return of

income tax for the calendar year 1946 and that Petitioner's original return of income tax for the calendar year 1947 was correct.

Dated, Honolulu, Hawaii,
February 25, 1957.

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